In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 682

THE OVERLAKES CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 2–34)[1] are reported at 41 T.C. 503. The majority and dissenting opinions of the court of appeals (Pet. A1–A6) are reported at 348 F. 2d 462.

JURISDICTION

The judgment of the Court of Appeals was entered on July 8, 1965 (Pet. 2). The petition for rehearing *en banc* was denied on August 3, 1965 (Pet. A7). The petition for a writ of certiorari was filed on Octo-

[1] Record references are to the appendix to the taxpayer's brief in the court of appeals.

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ber 20, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

The taxpayer sold wire to the government in 1951 and 1952 under a defense contract, and accrued the total contract price as income on the basis of shipments in those years. The contract was subject, however, to revision of the price, and the price was, in fact, later revised downward and a refund made by the taxpayer to the government. The question presented is whether, for purposes of computing the tax credit to which the taxpayer is entitled under Section 3806 of the Internal Revenue Code of 1939, it was reasonable to allocate the refund between 1951 and 1952 on the same basis that the original contract price had been accrued as income in those years.

STATUTE INVOLVED

The pertinent provisions of Section 3806 of the Internal Revenue Code of 1939 are set out in the Appendix, *infra*, pp. 7–8.

STATEMENT

The pertinent facts as found by the Tax Court (R. 5–21) may be summarized as follows:

On January 17, 1951, the taxpayer entered into a contract for the sale of wire to the government. The contract contained a price revision clause providing that because of the experimental and developmental nature of the work called for by the contract, and the great uncertainty as to the cost of performance, the

parties, after completion of the contract, would negotiate to agree upon a reasonable revised price for the entire contract; and such revised price might be more or less than the price originally fixed (R. 5–6).

The taxpayer received, for deliveries of wire under the contract, a total consideration of $5,024,598[2] based on the estimated price, and accrued this amount on the basis of miles shipped, resulting in income of $2,116,505 in 1951 and $2,908,093 in 1952. After completion of the contract, the parties agreed upon a redetermined contract price of $4,548,986, and the taxpayer accordingly refunded $475,612 to the government in 1954, representing the difference between the total consideration of $5,024,598 received by the taxpayer and the revised price of $4,548,986 (R. 9–19).

In computing the taxpayer's tax credit under Section 3806 of the 1939 Code, the Internal Revenue Service determined that the amount of the refund ($475,612) should be allocated between the years 1951 and 1952 in proportion to the amounts originally accrued as income in those years (R. 9, 30). This resulted in an allocation of $200,353 to 1951 and $275,259 to 1952.

The Tax Court unanimously sustained this allocation (R. 32). The taxpayer appealed, contending that the entire $475,612 represented excessive profits which had been earned in 1952 and which should therefore be subtracted from its income for that year, producing a greater Section 3806 credit than allowed by the Tax Court for 1952. The court of appeals affirmed *per curiam*, one judge dissenting (Pet. Ad. A6).

[2] Round dollar amounts are used for convenience.

The taxpayer's petition for rehearing *en banc* was denied (Pet. A7).

ARGUMENT

1. Section 3806(a)(1) of the 1939 Code provides, in essence, that where as a result of renegotiation the taxpayer is compelled to refund as excessive profits a portion of the original contract price, the excessive profits eliminated shall be subtracted from the part of the contract price originally received or accrued for the prior taxable year; and a tax credit shall be allowable accordingly for the prior year. The single question presented is whether it was proper to allocate the amount the taxpayer here was required to refund on the same basis as it had originally accrued the income under the contract over 1951 and 1952. We submit that it clearly was. The price reduction that the parties agreed upon was a revision of the entire contract price for goods shipped in 1951 and 1952; the effect of the renegotiation was to substitute a new price for the price in the original contract. Cf. *Wener* v. *Commissioner*, 24 T.C. 529, 532, affirmed, 242 F. 2d 938 (C.A. 9). Since the original contract price had been accrued over both years, it was logical to allocate the revised price between the two years on the same basis, rather than bunch the entire refund in the second year. The taxpayer's attempt to show that the refund in fact represented excessive profits earned in 1952, and not in 1951, is inconsistent with the accrual method of accounting it employed, whereby its income under the contract was spread between the two years on the basis of shipments; and with the terms of the renegotiation agree-

ment, which involved a revision of the entire contract price rather than a redetermination of profits as such.

2. There is no conflict between the decision below and that of the Eighth Circuit in *McDonnell Aircraft Corp.* v. *United States*, 342 F. 2d 943, as the court below (Pet. A3) and the court in *McDonnell* (342 F. 2d at 950) both recognized. The basis of the holding in *McDonnell* that the renegotiation refund was attributable in its entirety to a single year was that there the refund was the result of a full-fledged renegotiation proceeding conducted on the basis of a particular taxable year involving many contracts, not, as here, on the basis of a particular contract. "Under the statute, renegotiation is conducted not with respect to individual contracts, but with respect to the receipts or accruals of a contractor under all renegotiable contracts and subcontracts in a fiscal year of the contractor." *The Renegotiation Board Ninth Annual Report 1964*, p. 2. Where the refund is on the basis of the year, not the contract, there is no basis for an allocation of the refund to other years. But where, as in the present case, there is no full-fledged renegotiation proceeding, but simply a price redetermination respecting a particular contract, the principle of the *McDonnell* case obviously does not require lumping the entire refund in a single year. The renegotiation here was in respect to a contract, not a year.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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NOVEMBER 1965.

*The Solicitor General having disqualified himself.

APPENDIX

Internal Revenue Code of 1939:

SEC. 3806. MITIGATION OF EFFECT OF RENEGOTIATION OF WAR CONTRACTS OR DISALLOWANCE OF REIMBURSEMENT.

(a) *Reduction for Prior Taxable Year.*—

(1) *Excessive profits eliminated for prior taxable year.*—In the case of a contract with the United States or any agency thereof, or any subcontract thereunder, which is made by the taxpayer, if a renegotiation is made in respect of such contract or subcontract and an amount of excessive profits received or accrued under such contract or subcontract for a taxable year (hereinafter referred to as "prior taxable year") is eliminated and, in a taxable year ending after December 31, 1941, the taxpayer is required to pay or repay to the United States or any agency thereof the amount of excessive profits eliminated or the amount of excessive profits eliminated is applied as an offset against other amounts due the taxpayer, the part of the contract or subcontract price which was received or was accrued for the prior taxable year shall be reduced by the amount of excessive profits eliminated. For the purposes of this section—

*** * (A) The term "renegotiation" includes any transaction which is a renegotiation within the meaning of the Federal renegotiation act applicable to such transaction, any modification of one or more contracts with the United States or any agency thereof,**

and any agreement with the United States or any agency thereof in respect of one or more such contracts or subcontracts thereunder.

(B) The term "excessive profits" includes any amount which constitutes excessive profits within the meaning assigned to such term by the applicable Federal renegotiation act, any part of the contract price of a contract with the United States or any agency thereof, any part of the subcontract price of a subcontract under such a contract, and any profits derived from one or more such contracts or subcontracts.

* * * * *

(b) *Credit Against Repayment on Account of Renegotiation or Allowance.*—

(1) *General rule.*—There shall be credited against the amount of excessive profits eliminated the amount by which the tax for the prior taxable year under Chapter 1, Chapter 2A, Chapter 2B, Chapter 2D, and Chapter 2E, is decreased by reason of the application of paragraph (1) of subsection (a); and there shall be credited against the amount disallowed the amount by which the tax for the prior taxable year under Chapter 1, Chapter 2A, Chapter 2B, Chapter 2D, and Chapter 2E, is decreased by reason of the application of paragraph (2) and subsection (a).

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